United States Court of Appeals

for the Second Circuit

APPELLEE'S BRIEF

Signed

74-1810

No. 74-1810

IN THE UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

ESTATE OF LORRAINE A. McGAULEY, Deceased,
FREDERICK F. McGAULEY, Temporary Executor,

Appellant

v.

COMMISSIONER OF INTERNAL REVENUE,

Appellee

ON APPEAL FROM THE DECISION OF THE
UNITED STATES TAX COURT

BRIEF FOR THE APPELLEE

SCOTT P. CRAMPTON,
Assistant Attorney General,

GILBERT E. ANDREWS,
LORING W. POST,
ROBERT G. BURT,
Attorneys,
Tax Division,
Department of Justice,
Washington, D. C. 20530.

2

TABLE OF CONTENTS

	Page
Statement of the question presented	1
Statement of the case	1
Summary of argument	5
Argument:	
Since amounts paid by an estate in settlement of a will contest are not included in the property ultimately "transferred" to a sole beneficiary, the Tax Court was correct in denying the taxpayer a credit under Section 2013 of the Internal Revenue Code of 1954	6
A. Introduction	6
B. Section 2013 of the Code specifically limits the credit for tax on prior transfers to property actually "transferred" to the decedent	8
C. Amounts paid by an estate in compromise of a will contest cannot be considered as part of the property ultimately "transferred" to a sole beneficiary	16
Conclusion	20
Appendix	22

CITATIONS

Cases:

Bahr v. Commissioner, 119 F. 2d 371 (C.A. 5, 1941), cert. denied, 314 U.S. 650 (1941)	11, 15, 16
Barrett v. Commissioner, 22 T.C. 606 (1954)	15
Bloedorn v. United States, 116 F. Supp. 133 (Ct. Cl., 1953)	11
Central Hanover B. & T. Co. v. Commissioner, 159 F. 2d 167 (C.A. 2, 1947)	11, 17
Commissioner v. Garland, 136 F. 2d 82 (C.A. 1, 1943)	11
Cook, Matter of, 187 N.Y. 253 (1907)	17, 18
Dutcher v. Commissioner, 34 T.C. 918 (1960)	15

Page

Cases (continued):

Hanch v. Commissioner, 19 T.C. 65 (1952)-------- 11
Lyeth v. Hoey, 305 U.S. 188 (1938)-------------- 15, 18, 19
Rice v. Commissioner, 7 T.C. 223 (1946)--------- 11
Thomas v. Earnest, 161 F. 2d 845 (C.A. 5, 1947)---------- 17
Tilyou, Estate of v. Commissioner, 470 F. 2d 693 (C.A. 2, 1972)---------- 18
United States Trust Co. of New York v. Commissioner, 321 F. 2d 908 (C.A. 2, 1963), aff'g 38 T.C. 670 (1962), cert. denied sub nom. Estate of Davenport v. Commissioner, 376 U.S. 937 (1964)---------- 15
Vath v. Commissioner, 41 B.T.A. 487 (1940)------ 10

Statutes:

Act of February 20, 1956, c. 66, 70 Stat. 26, Sec. 1---------- 10
Estates, Powers and Trusts Law, McKinney's Consol. Laws of N.Y. Ann., §1-2.18--------- 17
Internal Revenue Code of 1939 (26 U.S.C., 1952 ed.):
Sec. 812---------- 10
Sec. 861---------- 10
Internal Revenue Code of 1954 (26 U.S.C.):
Sec. 2013---------- 6, 22
Sec. 2052---------- 12
Revenue Act of 1926, c. 27, 44 Stat. 9, Sec. 303---------- 10
Vernon's Tex. Civil Stat. Ann., Art. 3314------- 17

Miscellaneous:

Chirelstein and Shiever, Revision of the Federal Estate and Gift Taxes: The Internal Revenue Act of 1954, 7 Stanford L. Rev. 40, 55-56 (1956)---------- 9
H. Rep. No. 767, 65th Cong., 2d Sess., p. 22 (1939-1 Cum. Bull. (Part 2) 86, 101-102)--- 9

Page

Miscellaneous (continued):

H. Rep. No. 1337, 83d Cong., 2d Sess, pp. 89-90 (3 U.S.C. Cong. & Adm. News (1954) 4017, 4452-4456)---------- 9
Lowndes and Kramer, Federal Estate and Gift Taxes (2d ed.), p. 537---------- 10
Rev. Rul. 66-139, 1966-1 Cum. Bull. 225---------- 15
S. Rep. No. 1622, 83d Cong., 2d Sess., pp. 121-122, 463-467 (3 U.S.C. Cong. & Adm. News (1954) 4621, 4754-4756---------- 9,13,19
Treasury Regulations on Estate Tax (1954 Code):
§20.2013-1---------- 9, 24
§20.2013-4---------- 12,24
§20.2013-5---------- 9, 25

IN THE UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 74-1810

ESTATE OF LORRAINE A. McGAULEY, Deceased,
FREDERICK F. McGAULEY, Temporary Executor,

Appellant

v.

COMMISSIONER OF INTERNAL REVENUE,

Appellee

ON APPEAL FROM THE DECISION OF THE
UNITED STATES TAX COURT

BRIEF FOR THE APPELLEE

STATEMENT OF THE QUESTION PRESENTED

Whether, for the purpose of determining the credit for estate tax paid on prior transfers under Section 2013 of the Internal Revenue Code of 1954, the Tax Court correctly held that amounts paid by the prior decedent's estate in settlement of a will contest were never "transferred" to the decedent, sole beneficiary under the contested will.

STATEMENT OF THE CASE

The taxpayer[1/] petitioned the Tax Court to redetermine a deficiency of $26,668.04 in federal estate tax liability

---

1/ The taxpayer herein is the Estate of Lorraine A. McGauley, represented by her son, Frederick F. McGauley, Jr., acting in the capacity of temporary executor. (R. 33a.)

determined by the Commissioner. (R. 33a.)[2/] The Tax Court (Honorable Charles R. Simpson) filed its opinion, reported at 61 T.C. 350, on December 12, 1973 (R. 32a-39a), and its decision on March 14, 1974 (R. 47a-48a). The taxpayer's timely notice of appeal was filed on May 21, 1974. (R. 3a.) Jurisdiction is conferred upon this Court by Section 7482 of the Internal Revenue Code of 1954.

The facts, as stipulated by the parties (R. 17a-20a) and adopted by the Tax Court (R. 33a-35a), may be summarized as follows:

Frederick F. McGauley (Frederick hereinafter) died on April 22, 1965. By his will, Frederick bequeathed to his wife, Lorraine A. McGauley (hereinafter decedent), his entire estate of $616,082.64. (R. 18a-19a, 33a, 81a-85a.) Immediately following his death, Frederick's four daughters by previous marriage (Mrs. Patricia McLaughlin, Mrs. Colleen Patten, Mr. Kathleen Michael, and Mrs. Nancy O'Reilly) filed objections to the admittance of the will to probate in the Surrogate's Court, County of Schenectady, New York. (R. 18a, 24a, 33a-34a, 88a-89a.) Pursuant to an agreement filed with the Surrogate's Court on June 29, 1966, between the decedent (acting in the capacity of preliminary executrix of her husband's estate) and Frederick's four daughters, all objections to the probate of Frederick's will were withdrawn on July 11, 1966, in exchange

2/ "R." references are to the separately bound record appendix.

for the payment of $27,500 to each of the daughters and the payment of $5,000 to the daughters' attorney for legal fees. (R. 18a-19a, 34a.) Based upon this agreement, the Estate of Frederick F. McGauley paid the agreed amounts (totaling $115,000) to Frederick's daughters and their attorney. (R. 34a.) Such payments were, by the express terms of the agreement, in full settlement of the daughters' individual claims against the estate. (R. 34a, 89a.)

Although the record is devoid of any similar will contest by Frederick and Lorraine's son, Frederick F. McGauley, Jr. (hereinafter Frederick, Jr.), in 1965, the decedent gave $10,404.93 worth of securities to him. On December 2, 1966, the decedent gave additional securities valued at $27,500 to Frederick, Jr., and, in 1967, also established a substantial trust for him with assets valued at $742,872.89. The terms of the trust provided that the decedent would retain the right to income for her life, with the remainder to her son (appointed as trustee). Gift tax returns were filed with respect to all three transfers. (R. 34a.)

On September 18, 1967, approximately 29 months after the death of her husband, the decedent died. (R. 33a.) In computing the amount of the federal estate tax due, the Estate of Lorraine A. McGauley (taxpayer herein) claimed a credit under Section 2013 of the Internal Revenue Code of 1954 (26 U.S.C.) for 80 percent of the federal estate tax paid on Frederick's estate.

In his notice of deficiency, the Commissioner disallowed any credit based upon that portion of Frederick's estate used to pay the $27,500 to each of Frederick's daughters, the $5,000 to their attorney, and the $27,500 to Frederick, Jr., on the ground that such amounts had never been "transferred" to the decedent as required by Section 2013. (R. 34a-35a.) Accordingly, a deficiency of $26,668.04 in federal estate tax was determined against the taxpayer. (R. 8a.)

The Tax Court upheld the Commissioner's determination that the amounts paid by Frederick's estate to his four daughters and their attorney (a total of $115,000) had never been "transferred" to the decedent for the purposes of Section 2013. (R. 38a.) With respect to the $27,500 of securities given by the decedent to Frederick, Jr., however, the court found that the transfer constituted a gift by the decedent of property acquired from her husband and, therefore, includable in the property "transferred" to her subject to the credit provided by Section 2013. (R. 39a.) The deficiency was accordingly reduced to $18,393.04. (R. 47a.) The taxpayer here appeals the determination of the court below insofar as it denied a credit under Section 2013 with respect to the payments to Frederick's daughters and their attorney.

SUMMARY OF ARGUMENT

Section 2013 of the Internal Revenue Code of 1954 (26 U.S.C.) provides for a sliding estate tax credit against federal estate tax for property transferred to the decedent from a prior decedent who died within the previous ten years. The credit is the lower of: (1) the portion of the estate taxes paid by the prior decedent's estate which is attributable to the property transferred to the decedent; or (2) the amount by which the transferred property might otherwise result in an increase in estate tax on the decedent's estate. A prerequisite to the credit, however, is that the property of the prior decedent must have been "transferred" to the decedent. Where a portion of the property in the prior decedent's estate has been expended in the administration of his estate, or otherwise dissipated prior to distribution to the decedent, the credit under Section 2013 is correspondingly reduced so that it is based solely upon property actually "transferred" to the decedent.

The facts in this case show that, during the administration of the prior decedent's estate, payments equaling $115,000 were made to four of the prior decedent's daughters and their attorney in compromise of their contest of the prior decedent's will. Following such payments, the contestants' objections to the probate of the prior decedent's will were withdrawn and the decedent remained as sole beneficiary of the prior decedent's estate. Upon the death of the decedent, the taxpayer contended that the credit under Section 2013 should be based upon the

value of the prior decedent's net estate, without diminution of the payments by the estate to the will contestants. The Commissioner and the court below held, that, inasmuch as the payments were made by the prior decedent's estate, such amounts were never "transferred" to the decedent and therefore could not be included in determining the Section 2013 credit.

The decision of the Tax Court is amply supported by the Code and Regulations, and should be affirmed by this Court.

ARGUMENT

I

SINCE AMOUNTS PAID BY AN ESTATE IN SETTLEMENT OF A WILL CONTEST ARE NOT INCLUDED IN THE PROPERTY ULTIMATELY "TRANSFERRED" TO A SOLE BENEFICIARY, THE TAX COURT WAS CORRECT IN DENYING THE TAXPAYER A CREDIT UNDER SECTION 2013 OF THE INTERNAL REVENUE CODE OF 1954

A. Introduction

Frederick F. McGauley died on April 22, 1965, leaving all of his estate to his wife, Lorraine A. McGauley, decedent herein, who died on September 16, 1967. (R. 33a.) The sole question involved in this appeal is the amount of the credit to be allowed the estate of Lorraine A. McGauley under Section 2013 of the Internal Revenue Code of 1954, Appendix, infra, for property previously taxed in Frederick's estate.

The taxpayer contends (Br. 4) that the credit for property previously taxed should properly be based upon Frederick's

adjusted gross estate of $616,082.64, upon which a federal estate tax of $57,288.14 was duly paid. (R. 6a.) In determining the present deficiency, however, the Commissioner held that the amount of the allowable credit must be proportionately reduced for amounts paid by Frederick's estate to his four daughters and their attorney in return for their withdrawal of opposition to the probate of Frederick's will. The amount of property deemed transferred to the decedent, Frederick's sole beneficiary, was thus diminished by $115,000 and, accordingly, the credit available to the taxpayer correspondingly reduced. (R. 8a-14a.)

The Tax Court found that Section 2013 applies only with respect to property "transferred" to the decedent, and therefore, since the amount paid to Frederick's daughters and their attorney was not part of the property transferred to the decedent, no credit based upon such amount was allowable. It is our contention that the Commissioner and the Tax Court were correct in disallowing any credit for the payments by Frederick's estate as the net estate remaining after the payments is all that the decedent could possibly have received from Frederick's estate. The Tax Court's decision, sustaining the Commissioner's position in this regard, should be affirmed.

B. Section 2013 of the Code specifically limits the credit for tax on prior transfers to property actually "transferred" to the decedent

In an effort to prevent the federal estate tax from operating too oppressively upon the estate of a decedent who acquires property from a prior decedent, Section 2013 was enacted to allow the estate of the decedent a credit for the federal estate tax paid by the prior decedent upon property transferred to the decedent within ten years before, or two years after, the decedent's death.[3/] This credit is generally limited to the lower of two sums: (1) the proportionate part of the estate tax paid by the prior decedent's estate with respect to the property transferred to the decedent; or (2) the amount by which the transferred property might otherwise result in an increase in

3/ Although hardship will generally result from the successive taxation of a family's wealth within a short period of time, that hardship conceivably becomes less severe as the interval between the decedent's death and that of the prior decedent grows longer. Accordingly, Section 2013 of the Internal Revenue Code of 1954 adopts a sliding-scale device for measuring the rate of tax on property previously taxed. Thus, a statutory percentage is applied to the credit base to determine the allowable credit; i.e., if the interval between deaths is two years or less, the statutory percentage of the credit base is 100 percent; if the interval is three or four years, the percentage drops to 80 percent; if five or six years, to 60 percent; if seven or eight years, to 40 percent; and if nine or ten years, to 20 percent. If the prior decedent died more than ten years before the decedent, the credit is disallowed entirely. Sec. 2013(a).

In the instant case, it is undisputed that the decedent died within the third year following the death of Frederick and therefore, under the statute, the taxpayer is entitled to claim 80 percent of the credit base. What constitutes the credit base, of course, is the subject of the instant controversy. (R. 17a-18a.)

estate tax for the decedent's estate. Sec. 2013(b) and (c) of the Code; Treasury Regulations on Estate Tax (1954 Code), §20.2013-1(b), Appendix, infra. 4/

Section 2013(a), however, allows an estate tax credit only with respect to property "transferred" to the decedent. The term "transfer" is defined in the Regulations, Section 20.2013-5(b), Appendix, infra, which states:

> In order to obtain the credit for tax on prior transfers, there must be a transfer of property described in paragraph (a) of this section by or from the transferor [prior decedent] to the decedent. * * * (Emphasis added.)

Indeed, the statute's legislative history states again and again that the credit is applicable only to property transferred to the decedent. H. Rep. No. 767, 65th Cong., 2d Sess., p. 22 (1939-1 Cum. Bull. (Part 2) 86, 101-102); S. Rep. No. 1622, 83d Cong., 2d Sess., pp. 121-122 (3 U.S.C. Cong. & Adm. News (1954) 4621, 4754-4756); H. Rep. No. 1337, 83d Cong., 2d Sess., pp. 89-90 (3 U.S.C. Cong. & Adm. News (1954) 4017, 4452-4456).

4/ Where, for instance, the decedent's estate is in a higher bracket than that of the prior decedent, the tax benefit allowed the decedent's estate may not exceed the amount of tax paid by the prior decedent's estate. The second limitation--sometimes referred to as the "transferee's tax"--is the amount by which the inclusion of the value of the transferred property in the decedent's gross estate will result in an increase of the decedent's estate tax. This limitation is aimed at cases in which the tax rates in the topmost bracket of the decedent's estate are lower than the average rates in the prior decedent's estate. In such cases, the tax benefit allowed cannot exceed an amount equal to the value of the property previously taxed multiplied by the highest bracket rates applicable to the decedent's estate. See Chirelstein and Shieber, Revision of the Federal Estate and Gift Taxes: The Internal Revenue Act of 1954, 7 Stanford L. Rev. 40, 55-56 (1954).

Under the Revenue Act of 1926, c. 27, 44 Stat. 9, Section 303(a)(2) provided that there could be deducted, [5/] "[a]n amount equal to the value of any property * * * where such property can be identified as having been received by the decedent * * * from such prior decedent * * * ." (Emphasis added.) Clearly this contemplated that there could only be deducted the value of the property that was actually received by the second decedent or his estate.

Under the 1939 Code, the adjustment for estate tax paid on prior transfers still took the form of a deduction, but was unsatisfactory in many respects. Secs. 812(c), 861(a) aof the 1939 Internal Revenue Code (26 U.S.C., 1952 ed.). For example, Section 812(c) of the 1939 Code provided that whenever a prior decedent's estate had paid any estate tax, the decedent's executor could deduct from the decedent's gross estate an amount equal to the value of all the property received from the prior decedent. Hence, if A, whose gross estate was $60,001 and whose estate paid an estate tax on only the $1, had transferred the $60,001 to B, B's estate could deduct the entire $60,001 from its gross estate. Vath v. Commissioner, 41 B.T.A. 487 (1940). See Lowndes and Kramer, Federal Estate and Gift Taxes (2d ed.), p. 537.

5/ Under both the Revenue Act of 1926 and the 1939 Code, a deduction (as opposed to a credit) was provided for property acquired by a decedent as a gift within five years of the decedent's death, or as a gift, bequest, devise, or inheritance from a prior decedent who died within five years of the decedent's death. Sec. 303 of the Revenue Act of 1926; Secs. 812(c) and 861(a)(2) of the 1939 Code. In 1954, Congress added Section 814 to the 1939 Code. This section permitted an executor to elect, in lieu of any deduction for previously taxed property, to take a credit for a tax on prior transfers under a very limited situation. Act of February 20, 1956, c. 66, 70 Stat. 26, Sec. 1.

Not only was this rule undesirable, but it also precipitated a conflict among the courts over how it was to be applied in different situations. Indeed, some courts held that the entire value of previously taxed property could be deducted from the decedent's gross estate even though that value exceeded the prior decedent's net estate. If, for example, claims against a prior decedent's estate were paid from earnings of the estate, a deduction was allowed to the decedent's estate for the total value of the prior decedent's gross estate--even though that full amount had not been subject to tax at his death. The result was similar when the prior decedent's gross estate had been distributed before the claims had been paid and the distributees satisfied claims out of other assets. See Commissioner v. Garland, 136 F. 2d 82 (C.A. 1, 1943); Hanch v. Commissioner, 19 T.C. 65 (1952); Rice v. Commissioner, 7 T.C. 223 (1946).

This Court and others, however, held that the value of property to be considered "transferred" to the decedent had to be reduced by the amount of claims and taxes to which the prior decedent's estate had been subjected. Central Hanover Bank & Trust Co. v. Commissioner, 159 F. 2d 167 (C.A. 2, 1947); Bahr v. Commissioner, 119 F. 2d 371 (C.A. 5, 1941), cert. denied, 314 U.S. 650 (1941). In Bloedorn v. United States, 116 F. Supp. 133 (Ct. Cl., 1953), for example, the prior decedent left an estate of $492,518.44 and named his wife as sole legatee and executrix. The prior decedent's wife paid the tax imposed on his estate with her own funds and died

four years later. Her estate argued that it should be allowed to deduct the full amount of $492,518.44 as property previously taxed, since that amount had comprised the prior decedent's estate. The Court of Claims, however, held that the wife's estate could deduct only that portion of the prior decedent's estate tax which remained after the estate tax had been subtracted.

Section 2013 of the Internal Revenue Code of 1954 remedied these defects of the 1939 Code. As discussed previously, it offered a credit machinery which limited relief to the lower of: (1) the proportionate part of the estate tax paid by the prior decedent's estate with respect to the transferred property; or (2) the amount by which the transferred property would increase the decedent's estate tax. Secs. 2013(a) and (b) of the Code; §20.2013-1(b) of the Regulations. For example, in the hypothetical case discussed earlier in which the prior decedent's estate was valued at $60,001, the credit available to the decedent's estate under Section 2013 would generally be limited to the tax paid on the prior decedent's net taxable estate--i.e., on the $1.[6/] In addition, under Section 2013(d), the value of the previously taxed property which is used to compute the credit must be reduced by any death taxes attributable to the property (Treasury Regulations on Estate Tax, §20.2013-4(b)(1), Appendix, infra), by any lien or encumbrance (Treasury Regulations, §20.2013-4(b)(3)(ii), Appendix, infra),

---

6/ Under Section 2052 of the Internal Revenue Code of 1954 (26 U.S.C.), the taxable estate is determined by deducting from the value of the gross estate an exemption of $60,000.

by the amount of any marital deduction allowed if the decedent was the prior decedent's spouse (Treasury Regulations, §20.2013-4 (b)(2), Appendix, infra), and by any obligation assumed by the decedent (Treasury Regulations, §20.2013-4(b)(3)(i), Appendix, infra). So too, if estate income is used to satisfy claims against the prior decedent's estate, thus increasing the amount of property received by the decedent, the legislative history of Section 2013 makes it clear that the increment should not be considered in valuing the property for purposes of determining the credit allowed to the decedent's estate. S. Rep. No. 1622, supra, pp. 463-467.

In the instant case, Frederick died testate on April 22, 1965. His will provided that his entire estate was to pass to his wife, Lorraine A. McGauley, the decedent herein. (R. 33a.) Frederick's four daughters initiated a bona fide will contest claiming that the provisions of Federick's will, naming the decedent sole beneficiary, were invalid. (R. 33a-34a.) On June 29, 1966, an agreement was executed between Frederick's four daughters and his estate to the effect that each daughter was to be paid the sum of $27,500, and their attorney an additional sum of $5,000 for his fee (a total of $115,000). (R. 34a, 87a-92a.) The pertinent provisions of the agreement state (R. 88a-89a):

> Whereas in the interest of a more harmonious family relationship and on account of the uncertainty of litigation and to prevent delay in the settlement of the estate and to save the expense and avoid the loss thereto by prolonged litigation, the parties and the persons represented believe it would be to the best interest of the estate to compromise and settle the said controversy, * * *
>
> * * *
>
> Now Therefore, this agreement witnesseth that subject to the approval of the Surrogate of the County of Schenectady and to become effective only as hereinafter stated, the parties hereto do hereby agree as follows:
>
> 1. The said contestants, Mrs. Patricia McLaughlin, Mrs. Colleen Patten, Mrs. Kathleen Michael and Mrs. Nancy O'Reilly, have agreed and do hereby agree to withdraw their objections and to accept the total amount of $115,000, including $5,000 as and for counsel fees * * * in full settlement of their individual claims against the said estate, * * * and the other party to this agreement does hereby agree that, upon the withdrawal of said objections and the consents and waivers to the probate * * *, said sum of $115,000 be paid to the said contestants * * * out of the assets of the estate of the said Fred F. McGauley, deceased. (Emphasis added.)

As reflected by the agreement between Frederick's four daughters and his estate, the payments to the daughters and their attorney were not made from property "transferred" from Frederick's estate to the decedent. To the contrary, the payments were made from his estate to the daughters. Such payments made in settlement of a bona fide will contest constitute the passing of property from the estate to the recipient of

such payment. Lyeth v. Hoey, 305 U.S. 188 (1938); United States Trust Co. of New York v. Commissioner, 321 F. 2d 908 (C.A. 2, 1963), aff'g 38 T.C. 670 (1962), cert. denied sub nom. Estate of Davenport v. Commissioner, 376 U.S. 937 (1964); Dutcher v. Commissioner, 34 T.C. 918 (1960); Barrett v. Commissioner, 22 T.C. 606 (1954).

In Lyeth v. Hoey, supra, the Supreme Court held that the receipt by the taxpayer in settlement of a will contest constituted a transfer of property from the estate to the taxpayer. Even though the case was concerned with the determination of income tax liability, it has consistently been held applicable in estate tax cases. United States Trust Co. of New York v. Commissioner, supra; Barrett v. Commissioner, supra; Rev. Rul. 66-139, 1966-1 Cum. Bull. 225 (and the cases cited therein).

The taxpayer contends (Br. 10), however, that the Tax Court's decision thwarts the intent of Congress in enacting Section 2013. The legislative history of the section, it correctly recites, shows that the purpose of Section 2013 was to avoid double taxation of the same property within a brief period of time. H. Rep. No. 1337, supra; S. Rep. No. 1622, supra. The taxpayer then erroneously concludes that, if the Commissioner is permitted to reduce the decedent's estate tax credit in respect to the will settlement payments, the same property will have been taxed twice within a three-year period. Such a contention is without foundation. The property from which the will settlement payments were made was admittedly taxed in Frederick's estate at the time

of his death, but it has not been taxed for the second time in the decedent's estate. Since Frederick's estate paid the $115,000 to his four daughters and their attorney, the decedent could not have received it as a legatee--therefore such property escaped taxation in the decedent's estate. There can be little doubt, therefore, that the $115,000 was never "transferred" to the decedent. In the absence of such a "transfer," no Section 2013 credit based upon such an amount is allowable in accord with the legislative and judicial development of the statute.

C. Amounts paid by an estate in compromise of a will contest cannot be considered as part of the property ultimately "transferred" to a sole beneficiary

The taxpayer argues (Br. 4-11) that, under the law of the State of New York, Frederick's property vested in the decedent at the instant of his death and, therefore, the payments to Frederick's daughters and their lawyer must have come not from Frederick's estate, but from the decedent. It is upon this premise then, that the taxpayer further contends that all of Frederick's taxable estate (including the $115,000 paid in settlement of the will contest), by operation of New York law, met the "transfer" requirement of Section 2013. 7/

7/ A similar contention was made in Bahr v. Commissioner, 119 F. 2d 371 (C.A. 5, 1941), cert. denied, 314 U.S. 650 (1941). In the Bahr case, Frank Bender died in 1934 and bequeathed all his property to his brother, Eugene. Eugene died a few months later, but before he had completed the administration of Frank's estate. The Commissioner there ruled that the net value of Frank's estate, its value after the deduction of its unpaid taxes and debts,

(continued)

To support its position, the taxpayer cites Matter of Cook, 187 N.Y. 253 (1907), where the widow instituted contest, and, in settlement, nephews and nieces of the testator assigned to her their residuary legacies. In considering the correct assessment of

7/ (continued)

measured the deduction (under the 1939 Code) from Eugene's estate for property previously taxed. Similar to the New York statute (Estates, Powers, and Trusts Law, McKinney's Consol. Laws of N.Y. Ann., §1-2.18) cited by the taxpayer herein (Br. 4), Texas law provided (Vernon's Tex. Civil Stat. Ann., Art. 3314):

> When a person dies, leaving a lawful will, all of his estate devised or bequeathed by such will shall vest immediately in the devisees or legatees * * *.

Like the instant taxpayer, Eugene's estate contended that, since under Texas law Frank's estate vested "immediately" in Eugene, Eugene's estate must include Frank's entire gross estate, unreduced by amounts needed to pay debts. In spite of the peculiar "vesting" provision of Texas law, the Fifth Circuit held that (119 F. 2d, p. 374-375):

> * * * Eugene was enriched only by the net amount of Frank's estate. He ought not to have his estate tax diminished because he did not pay Frank's debts, thus acquiring a larger gross estate and larger deductions as for claims against his own estate. * * *
>
> The federal estate tax and State inheritance tax assessed against the estate of Frank, though paid by petitioners after the death of Eugene, are not claims against the estate of Eugene. They go to reduce the value of property received by Eugene's estate from Frank's, along with his fourth of the partnership debts and administration charges, as the Commissioner ruled.

So too, in the instant case, although the payments of $115,000 to Frederick's four daughters and their attorney were not charges against Frederick's estate, they still reduced the value of property ultimately "transferred" to the decedent. Without having been received by the decedent, such amounts clearly cannot provide the basis for a credit under Section 2013. See Central Hanover B. & T. Co. v. Commissioner, 159 F. 2d 167 (C.A. 2, 1947); Thomas v. Earnest, 161 F. 2d 845 (C.A. 5, 1947).

New York State succession tax, the court said (pp. 259-260):

> The compromise did not change the will. No settlement could change a word that the testator wrote. * * * As we said in another case, she [contestant] takes under them [legatees] "by contract, not under the will or from the testator." (Greenwood v. Holbrook, 111 N.Y. 465, 471.) * * * Here the legatees took the residuum under the will. They succeeded the testator in the ownership thereof and their succession gives rise to the tax. The widow did not take the residue from the testator, for he did not give it to her. She took as assignee, not as legatee. Unless she took as assignee, she did not take at all. The legatees assigned to her and the rate of taxation is fixed by their relation to the testator.

It is readily apparent that Matter of Cook, supra, is materially distinguishable from the instant case, because here, as in Lyeth v. Hoey, supra, the contestants took from the estate of their father and not from the legatee named in the will. The situation is clarified by noting that in the present case, the decedent's son took from his mother by way of gift, and not as an heir of his father, and, accordingly, the Tax Court held that the amount paid to the son was not excludable from the property transferred by Frederick's estate for purposes of the credit under Section 2013. (R. 39a.) The Commissioner has not appealed from that determination.

It is true that a will speaks as of the date of death of the testator, as stated by the taxpayer. (Br. 4.) And it may be that under New York law, the will of the husband (Frederick) took effect upon his death (Estates, Powers, and Trusts Law, §1-2.18; Estate of Tilyou v. Commissioner, 470 F. 2d 693 (C.A. 2, 1972),

thus entitling Lorraine (the instant decedent) to his entire net estate. It does not follow, however, that she as legatee actually received or became entitled to receive the amounts here in controversy that were distributed to his daughters and their attorney. Quite to the contrary, it is clear that she acted in behalf of her husband's estate in paying such amounts to the daughters. Even if she were the sole legatee under New York law, the daughters took as heirs of their father and not as assignees of their stepmother for purposes of the federal statute (Sec. 2013 of the Code) that concerns us here. As the Court pointed out in Lyeth v. Hoey, supra, pp. 193-194, the construction of a federal statute is not determined by the state law unless the federal taxing act by express language or necessary implication makes its operation dependent upon state law.

As pointed out above, in enacting Section 2013, Congress intended to avoid double taxation of property in the estates of two decedents who die within a brief period of time. H. Rep. No. 1337, supra, p. 90; S. Rep. No. 1622, supra, pp. 463-467. Such exemption cannot, however, be extended to property that fails to find its way to the second decedent. As we read Lyeth v. Hoey, supra, 305 U.S., p. 196, the Supreme Court has clearly indicated that amounts distributed by an estate to heirs of the decedent pursuant to a compromise such as we have here should be treated as received by them from the estate, and not by assignment from the legatee named in the will. The property transferred to

Frederick's four daughters and their attorney was included in Frederick's estate and taxed accordingly. Frederick's estate, not the decedent, compromised the contest of his will by the transfer of $115,000 directly to the contestants. It is clear that none of the $115,000 was ever transferred to the decedent. In absence of such transfer, the taxpayer is not entitled to a credit for estate tax paid by Frederick's estate on such amounts under Section 2013.

CONCLUSION

For the reasons stated herein, the decision of the Tax Court is correct and should be affirmed.

Respectfully submitted,

SCOTT P. CRAMPTON,
Assistant Attorney General,

GILBERT E. ANDREWS,
LORING W. POST,
ROBERT G. BURT,
Attorneys,
Tax Division,
Department of Justice,
Washington, D. C. 20530.

AUGUST, 1974.

CERTIFICATE OF SERVICE

It is herby certified that service of this brief has been made on opposing counsel by mailing four copies thereof on this 29th day of August, 1974, in an envelope, with postage prepaid, properly addressed to him as follows:

Mark L. Heller, Esquire
NOLAN & HELLER, P.C.
60 State Street
Albany, New York 12207

Gilbert E. Andrews/ank

GILBERT E. ANDREWS,
Attorney.

APPENDIX

Internal Revenue Code of 1954 (26 U.S.C.):

SEC. 2013. CREDIT FOR TAX ON PRIOR TRANSFERS.

(a) General Rule.--The tax imposed by section 2001 shall be credited with all or a part of the amount of the Federal estate tax paid with respect to the transfer of property (including property passing as a result of the exercise or non-exercise of a power of appointment) to the decedent by or from a person (herein designated as a "transferor") who died within 10 years before, or within 2 years after, the decedent's death. If the transferor died within 2 years of the death of the decedent, the credit shall be the amount determined under subsections (b) and (c). If the transferor predeceased the decedent by more than 2 years, the credit shall be the following percentage of the amount so determined--

(1) 80 percent, if within the third or fourth years preceding the decedent's death;

(2) 60 percent, if within the fifth or sixth years preceding the decedent's death;

(3) 40 percent, if within the seventh or eighth years preceding the decedent's death; and

(4) 20 percent, if within the ninth or tenth years preceding the decedent's death.

(b) Computation of Credit.--Subject to the limitation prescribed in subsection (c), the credit provided by this section shall be an amount which bears the same ratio to the estate tax paid (adjusted as indicated hereinafter) with respect to the estate of the transferor as the value of the property transferred bears to the taxable estate of the transferor (determined for purposes of the estate tax) decreased by any death taxes paid with respect to such estate and increased by the exemption provided for by section 2052 or section 2106(a)(3), or the corresponding provisions of prior laws, in determining the taxable estate of the transferor for purposes of the estate tax. For purposes of the preceding sentence, the estate tax paid shall be the Federal estate tax paid increased by any credits allowed against such estate tax under section 2012, or corresponding provisions of prior laws, on account of gift tax, and for any credits allowed

against such estate tax under this section on account of prior transfers where the transferor acquired property from a person who died within 10 years before the death of the decedent.

(c) Limitation on Credit.--

(1) In general.--The credit provided in this section shall not exceed the amount by which--

(A) the estate tax imposed by section 2001 or section 2101 (after deducting the credits for State death taxes, gift tax, and foreign death taxes provided for in sections 2011, 2012, and 2014) computed without regard to this section, exceeds

(B) such tax computed by excluding from the decedent's gross estate the value of such property transferred and, if applicable, by making the adjustment hereinafter indicated.

* * *

(d) Valuation of Property Transferred.--The value of property transferred to the decedent shall be the value used for the purpose of determining the Federal estate tax liability of the estate of the transferor but--

(1) there shall be taken into account the effect of the tax imposed by section 2001 or 2101, or any estate, succession, legacy, or inheritance tax, on the net value of the decedent of such property;

(2) where such property is encumbered in any manner, or where the decedent incurs any obligation imposed by the transferor with respect to such property, such encumbrance or obligation shall be taken into account in the same manner as if the amount of a gift to the decedent of such property was being determined; and

(3) if the decedent was the spouse of the transferor at the time of the transferor's death, the net value of the property transferred to the decedent shall be reduced by the amount allowed under section 2056 (relating to marital deductions), or the corresponding provision of prior law, as a deduction from the gross estate of the transferor.

(e) Property Defined.--For purposes of this section, the term "property" includes any beneficial interest in property, including a general power of appointment (as defined in section 2041).

Treasury Regulations on Estate Tax (1954 Code):

§20.2013-1 Credit for tax on prior transfers.

* * *

(b) Limitations on credit. The credit for tax on prior transfers is limited to the smaller of the following amounts:

(1) The amount of the Federal estate tax attributable to the transferred property in the transferor's estate, computed as set forth in §20.2013-2; or

(2) The amount of the Federal estate tax attributable to the transferred property in the decedent's estate, computed as set forth in §20.2013-3.

Rules for valuing property for purposes of the credit are contained in §20.2013-4.

* * *

§20.2013-4 Valuation of property transferred.

* * *

(b) In arriving at the value of the property transferred to the decedent, the value at which the property was included in the transferor's gross estate (see paragraph (a) of this section) is reduced as follows:

(1) By the amount of the Federal estate tax and any other estate, inheritance, legacy, or succession taxes which were payable out of the property transferred to the decedent or which were payable by the decedent in connection with the property transferred to him. For example, if under the transferor's will or local law all death taxes are to be paid out of other property with the result that the decedent receives a bequest free and clear of all death taxes, no reduction is to be made under this subparagraph;

(2) By the amount of any marital deduction allowed the transferor's estate under section 2056 (or under section 812 (e) of the Internal Revenue Code of 1939) if the decedent was the spouse of the transferor at the time of the transferor's death; and

(3) (i) By the amount of any encumbrance on the property or by the amount of any obligation imposed by the transferor and incurred by the decedent with respect to the property, to the extent such charges would be taken into account if the amount of a gift to the decedent of such property were being determined.

(ii) For purposes of this subparagraph, an obligation imposed by the transferor and incurred by the decedent with respect to the property includes a bequest, etc., in lieu of the interest of the surviving spouse under community property laws, unless the interest was, immediately prior to the transferor's death, a mere expectancy. (As to the circumstances under which the interest of a surviving spouse is regarded as a mere expectancy, see the provisions of paragraph (d) of §20.2056 (c)-2 which are equally applicable here.) However, an obligation imposed by the transferor and incurred by the decedent with respect to the property does not include a bequest, devise, or other transfer in lieu of dower, curtesy, or of a statutory estate created in lieu of dower or curtesy, or of other marital rights in the transferor's property or estate.

* * *

§20.2013-5 "Property" and "transfer" defined.

(a) For purposes of section 2013 and §§ 20.2013-1 to 20.2013-6, the term "property" means any beneficial interest in property, including a general power of appointment (as defined in section 2041) over property. Thus, the term does not include an interest in property consisting merely of a bare legal title, such as that of a trustee. Nor does the term include a power of appointment over property which is not a general power of appointment (as defined in section 2041). Examples of property, as described in this paragraph, are annuities, life estates, estates for terms of years, vested or contingent remainders and other future interests.

(b) In order to obtain the credit for tax on prior transfers, there must be a transfer of property described in paragraph (a) of this section by or from the transferor to the decedent. The term "transfer" of property by or from a transferor means any passing of property or an interest in property under circumstances which were such that the property or interest was included in the gross estate of the transferor. In this connection, if the decedent receives property as a result of the exercise or nonexercise of a power of appointment, the donee of the power (and not the creator) is deemed to be the transferor of the property if the property subject to the power is includible in the donee's gross estate under section 2041 (relating to powers of appointment). Thus, notwithstanding the designation by local law of the capacity in which the decedent takes, property received from the transferor includes interests in property held by or devolving upon

the decedent: (1) As spouse under dower or curtesy laws or laws creating an estate in lieu of dower or curtesy; (2) as surviving tenant of a tenancy by the entirety or joint tenancy with survivorship rights; (3) as beneficiary of the proceeds of life insurance; (4) as survivor under an annuity contract; (5) as donee (possessor) of a general power of appointment (as defined in section 2041); (6) as appointee under the exercise of a general power of appointment (as defined in section 2041); or (7) as remainderman under the release or nonexercise of a power of appointment by reason of which the property is included in the gross estate of the donee of the power under section 2041.

* * *